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Wednesday » October 24 » 2007

My crash course in investing
Lessons of 1987 served me well this past summer

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Financial Post

Saturday, October 20, 2007

In hindsight, it was the best human psychology, business, economics and history lesson I could have possibly had -- better than anything I ever learned in school.

Twenty years and a day ago I survived the Crash of '87. As a discount broker no less. To this day, I can remember it clearly, but I won't go into the event itself, as the media has taken care of that for me already.

Instead, I will try to outline what I learned during that period in capital markets, as it, no doubt, still has relevance today.

First lesson: markets recover. For investors, the world "ends" every so often. Be it a crash or a sub-prime panic or an ABCP meltdown, there is always an occasional crisis to deal with.

What you do in the crisis will either get you rich or

cause you more pain. Often, the best course of action is to do nothing.

Regardless of your actions, though, markets will recover. The question is, how long will the recovery take?

In 1987, markets rose above their pre-crash levels in less than three months. Imagine, the worst crash ever, and three months later it was as if nothing had happened.

Twenty years on, the share prices set that October seem like a joke: Bank of Nova Scotia (split adjusted) $3.34 per share. It's now $51. Heck, even its dividend now is $1.80 per share.

Goldcorp, $2.50 per share, now $32. Apple Inc. $9.13 (it fell 24% the day of the crash); now $165. Okay, I have made my point. Given time, markets have great ability to survive "shocks."

Second lesson: Investors often sell only because others are selling. In October, 1987, there was no Internet trading, and communications seemed almost primitive to today's standards.

During the early afternoon of the 1987 crash, I was having a calm, rational conversation with a client. As a discount broker, I could not give "advice," I could only offer a sympathetic voice.

Client A as we'll call him, was talking about staying the course, not panicking, and perhaps buying.

Suddenly, the Bell Canada operator (do they still have those?) broke into the line with an "emergency" call. I had a conference call in place way before three-way calling was perfected. Suddenly, I had Client B on the line at the same time as Client A. Client B was panicking about the market in a big way. He wanted to sell--now.

Then Client A says, and I quote: "I was here first. I want to sell now!" Client A, hearing the fear in Client Bs voice, decided to become irrational.

The lesson served me well this year; when I was aggressively putting in buy orders on Aug. 16 (admittedly while curled up in a ball under my desk).

Many investors that day sold just because the market was falling, not because of fundamentals.

Third and fourth lessons: In 1987, where I worked I had a client who had been, effectively, predicting a market crash for months.

Every month since about April of that year, this client aggressively bought put options on stocks and the indices in general.

Every month, he lost money. His $100,000 in capital had been whittled down to about $30,000 in October, but on the first of the month, he went all in and scored big.

On the day of the crash, some of the options he bought for 25¢ or so were trading at $10, $12, even $20. His $30,000 turned into about $760,000.

Not a bad pass. For this client, though, it wasn't enough. He kept buying put options, betting that the market was going to keep falling.

Of course, option premiums got extremely expensive after the crash, and the premiums ate up his capital like crazy. By December, because the market recovered and his put options stayed expensive, he was back to $50,000 or so -- a complete round trip.

Lessons here: (1) Greed, unlike what Gordon Gekko said in the movie Wall Street might not be so good.

This client was simply greedy, having frittered away a major pass on the options market. (2) The time to buy insurance is before the hurricane hits, not after. Once the crash occurs, you likely don't need insurance anymore.

Because of this, I watch the VIX volatility index closely. When it spikes because investors are panicking, it is often time to be aggressive -- another 1987 lesson that served me well in this year's Aug. 16 "crash."

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